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Clerk.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1908.

No. 13

THE HANOVER NATIONAL BANK OF THE CITY OF NEW YORK,
Appellant,

vs.

WILLIAM F. SUDDATH, AS RECEIVER OF THE AMERICAN NATIONAL BANK OF ABILENE.

APPEAL FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR APPELLANT.

PERCY S. DUDLEY,
Of Counsel.

THE EVENING POST JOB PRINTING OFFICE, 156 FULTON ST., N. Y.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1908.

No. 164.

THE HANOVER NATIONAL BANK OF THE CITY OF NEW YORK, Appellant,

vs.

WILLIAM F. SUDDATH, as Receiver of The American National Bank of Abilene.

Appeal from the United States Circuit Court of Appeals for the Second Circuit.

Brief for the Appellant.

This suit was brought by The Hanover National Bank of the City of New York to restrain William F. Suddath, as Receiver of The American National Bank of Abilene, Texas, from the prosecution of an action at law to recover from the possession of the complainant four promissory notes, or the balance of proceeds thereof, alleged to be the property of the Abilene Bank, to ascertain the amount due from said Abilene Bank or its Receiver to the Han-

over Bank, and to set off said amount against the claim of the Receiver, on the ground that the complainant had no adequate remedy at law, but in equity was entitled to such set-off (fols. 10 and 11). The defendant Receiver demurred to the complainant's bill, and, on an application by the complainant for a preliminary injunction, it was stipulated by the parties that the cause should be taken as submitted upon final hearing upon the bill of complaint and the demurrer; whereupon it was decreed that the bill of complaint be dismissed (fols. 13-15). The complainant appealed to the Circuit Court of Appeals, which affirmed the decree of the Circuit Court (fol. 30), and the complainant then appealed to this Court (fol. 32).

Specification of Error.

First.—That the Court erred in affirming the decree of the Circuit Court, sustaining the demurrer of the defendant-appellee on the ground that it appeared by the complainant's bill that said bill was insufficient and devoid of equity and that the complainant was not entitled to the relief prayed by said bill against the defendant-appellee.

Second.—That the Court erred in affirming the decree of the Circuit Court, refusing to allow the complainant-appellant to set off the amount due to it from The American National Bank of Abilene at the time of the appointment of the above-named William F. Suddath as Receiver of the said The American National Bank of Abilene against the claim made against the complainant-appellant by said William F. Suddath as such receiver.

Third.—That the Court erred in affirming the decree of the Circuit Court, refusing to enjoin the defendant-appellee from the prosecution of any ac-

tion at law for the enforcement of his claim against the complainant-appellant.

FOURTH.—That the Court erred in affirming the decree of the Circuit Court, dismissing the complainant's bill of complaint (fols. 35 and 36).

Statement of Facts.

The facts are stated in the bill of complaint and are identical, so far as the transaction itself is concerned, with those involved in the case of the Hanover National Bank against Suddath (No. 163), argued herewith upon a writ of error to review the affirmance of the judgment at law entered in favor of the Receiver for the recovery of the notes, or the proceeds thereof, referred to above.

The Hanover Bank, for more than a year prior to January, 1905, had been the New York correspondent of the Abilene Bank. The latter bank kept with the Hanover Bank an ordinary general deposit account, making deposits and withdrawing them by checks or other obligations, and from time to time, accounts current were rendered and balances were adjusted between the banks. From time to time, the Abilene Bank forwarded to the Hanover Bank notes or commercial paper made by various persons and owned by said bank, endorsing such notes and offering them to the Hanover Bank for discount, with a request that, in case the Hanover Bank should discount said notes, the proceeds thereof should be deposited to the credit of the Abilene Bank in its deposit account. On November 27, 1903, the Abilene Bank signed an agreement, by which a special lien was created in favor of the Hanover Bank for advances (fols. 3 and 4).

On January 14, 1905, the Hanover Bank received from the Abilene Bank notes of third persons for $2,000 and $3,000 respectively, with the request that the Hanover Bank discount the same and place the

proceeds to the credit of the Abilene Bank, which the Hanover Bank declined to do and informed the Abilene Bank by telegraph to that effect. On January 16, 1905, the Hanover Bank received from the Abilene Bank two other notes for $3,500 and $1,500 respectively, for discount and credit, and replied by telegraph that it declined to make the discount. The Hanover Bank held said four notes awaiting further instructions from the Abilene Bank (fols. 4 and 5).

On January 17, 1905, the balance of the Abilene Bank in its deposit account was $616.15, and during that day its checks drawn on the Hanover Bank to the amount of $4,192.01 were presented for payment. The Hanover Bank, without knowledge of any insolvency of the Abilene Bank and in reliance upon the possession of the four notes above referred to, allowed an overdraft and paid out for account of the Abilene Bank $3,563.86 in excess of the balance on deposit. The Hanover Bank entered this advance upon its books as a temporary loan of $3,500 (fols. 6 and 7).

On January 18, 1905, the Abilene Bank became openly insolvent and closed its doors, and a receiver was appointed by the Comptroller (fol. 2). Subsequently, the Hanover Bank collected from the four notes sufficient to pay the $3,500 loan and returned the remaining note and balance of proceeds to the Receiver. The sum retained (including principal and interest) amounted to $3,725.86 on November 20, 1906 (fols. 7 and 8).

The Receiver demanded the return of the four notes, making no tender of the amount due from the Abilene Bank, and thereafter began an action in the United States Circuit Court for the Southern District of New York to recover possession of the four notes. The Hanover Bank answered in said action, setting forth the circumstances under which said notes were received and the payment of the

overdraft in reliance thereon and claiming a lien thereon by virtue of its banker's lien, as well as by the terms of the collateral agreement above referred to, and claiming the right to set-off the indebtedness of the Abilene Bank to it against said notes or their proceeds. That cause was tried on November 14, 1905, and Judge Lacombe directed a verdict in favor of the defendant. Upon writ of error the Circuit Court of Appeals reversed the judgment entered and ordered a new trial (*Van Zandt* vs. *Hanover Nat. Bank, 149 Fed. Rep. 127*). In the opinion of Judge Wallace, it was held in substance that the defendant therein was not entitled to set-off or counterclaim the indebtedness owing to it by the Abilene Bank when the latter became insolvent; that such a defense was not available in an action at law for conversion, and that if the defendant therein had any right of equitable set-off, it should have been asserted by a bill in equity. Thereafter a new trial was had and a verdict directed in favor of the plaintiff in said action for $3,725.86, and the plaintiff threatened to enter judgment on the verdict. Thereupon, the Hanover Bank filed its bill of complaint herein to restrain the prosecution of said action at law and to obtain from a court of equity the set-off and other relief to which it was not entitled in a court of law. The Receiver demurred to the bill of complaint, and upon the hearing Judge Lacombe directed the complaint to be dismissed and a decree to that effect was entered (fols. 8-16).

Argument.

The Hanover Bank was entitled, in equity, to set-off the indebtedness due to it from the Abilene Bank against the claim of the Receiver for the notes owned by the Abilene Bank, or the proceeds thereof.

It is undisputed that the advance of $3,500 was

made to the Abilene Bank in reliance upon the possession of the notes claimed by the Receiver and in the belief that the Hanover Bank would have a lien upon the notes for the amount advanced. At the time the checks were presented the Hanover Bank was safe; no legal obligation rested upon it to pay the checks in excess of the deposit account; and no advantage could result to it if it did pay them. But the circumstances were somewhat extraordinary. The Abilene Bank probably expected the notes to be discounted and relied upon the proceeds to meet the checks then outstanding. When the Hanover Bank refused the discount, it at once notified the Abilene Bank to ship currency from Abilene, or transfer a credit balance from some other city. If this had been done promptly, the Hanover Bank would have had the funds by January 18th. Not receiving any remittance, the Hanover Bank again telegraphed to know what the Abilene Bank had done. Still it received no money and no instructions, and checks for over $4,000 were presented for payment. The Hanover Bank could, of course, have thrown the checks out, and apparently the Receiver thinks it should have done so. While the Hanover Bank had no suspicion that the Abilene Bank was actually insolvent, it naturally realized that the Abilene Bank needed money and that refusal of the checks might ruin its credit and turn a momentary embarrassment into public insolvency. It probably felt a moral obligation, because the situation was created in part by its failure to comply with the request of the Abilene Bank. The Hanover Bank therefore acted as the best interests of the Abilene Bank seemed to require, and as it felt the officers of that bank would have acted had they been present. It is inconceivable that those officers would have decided not to pledge the notes for their immediate needs, even if they could not get

the full discount. The Hanover Bank loaned the money to pay the checks and protect the credit of the Abilene Bank, trusting in the possession of the notes to secure it until the Abilene Bank could make such arrangement as it wished. If the Abilene Bank had not closed its doors almost at once, no criticism of the action of the Hanover Bank would ever have been made. No one can deny that by payment of the overdraft, a valid indebtedness from the Abilene Bank was thereby created which was due and payable immediately and prior to the insolvency. The Receiver took the estate of the insolvent bank with all its obligations; in fact, the insolvency of the Abilene Bank is an additional reason why this court of equity should intervene to do justice between the parties.

The decision in *Scott* vs. *Armstrong*, *146 U. S., 499*, the facts and procedure in which were somewhat similar to the case at bar, fully states the principles of law applicable to this case.

Fuller, *Ch. J.*, held that the Receiver took the assets of the Fidelity Bank as a mere trustee for creditors, subject to all claims and defenses which might have been interposed against the insolvent corporation before the liens of the United States and of general creditors attached.

> "The right to assert set-off at law is of "statutory creation, but courts of equity "from a very early day were accustomed to "grant relief in that regard independently, "as well as in aid of statutes upon the sub-"ject.
>
> "In equity, relief was usually accorded, "says Mr. Justice Story (Eq. Jur., Sec. "1435), 'where, although there are mutual "and independent debts, yet there is a mutual "credit between the parties, founded, at the "time, upon the existence of some debts due "by the crediting party to the other. By "mutual credit, in the sense in which the "terms are here used, we are to understand,

"a knowledge on both sides of an exist-
"ing debt due to one party and a credit by
"the other party, founded on, and trusting
"to such debt, as a means of discharging it.'

"This definition is hardly broad enough to
"cover all the cases where, as the learned
"commentator concedes, there being a 'con-
"nection between the demands, equity acts
"upon it and allows a set-off under partica-
"lar circumstances' (Sec. 1434). Courts of
"equity frequently deviate from the strict
"rule of mutuality, when the justice of the
"particular case requires it, and the ordin-
"ary rule is that where the mutual obliga-
"tions have grown out of the same transac-
"tion, insolvency on the one hand justifies
"the set-off of the debt due upon the other
"(*Blount* vs. *Windley*, 95 U. S., 173, 177)."

The learned Chief Justice then cited *Carr* vs. *Hamilton*, 129 U. S., 252, where the amount due on an endowment policy of an insolvent insurance company was set-off against the amount due on a mortgage from the holder of the policy. He also cited *Scammon* vs. *Kimball*, 92 U. S., 362, where a banker holding insurance in an insolvent company was allowed to set-off against the amount of insurance on his property, the amount of the company's deposit in his hands. He then said:

"Indeed, natural justice would seem to
"require that where the transaction is such
"as to raise the presumption of an agreement
"for a set-off, it should be held that the
"equity that this should be done is superior
"to any subsequent equity not arising out
"of a purchase for value without notice. In
"the case at bar, the credits between the
"banks were reciprocal and were parts of
"the same transaction, in which each gave
"credit to the other on the faith of the simul-
"taneous credit, and the principle applicable
"to mutual credits applied."

After deciding that the provisions of the National Bank Act forbidding preferences did not prevent the application of this principle, he said:

> "Undoubtedly, any disposition by a "National Bank, being insolvent or in con-"templation of insolvency, of its choses in "action, securities or other assets, made to "prevent their application to the payment of "its circulating notes, or to prefer one cred-"itor to another, is forbidden; but liens, "equities or rights arising by express agree-"ment, or implied from the nature of the "dealings between the parties, or by opera-"tion of law, prior to insolvency and not in "contemplation thereof, are not invalidated. "The provisions of the act are not directed "against all liens, securities, pledges or "equities, whereby one creditor may obtain "a greater payment than another, but "against those given or arising after or in "contemplation of insolvency."

The Court then held that the set-off should have been allowed by the Court sitting in equity.

This case is recognized as the leading authority upon the subject; as for example, in Bispham's Principles of Equity (7th Ed., 1905, Sec. 327), it is said:

> "Courts of Chancery frequently deviate "from the strict rule of mutuality when the "justice of the particular case (*e. g.*, insol-"vency of one of the parties) requires it,"

citing Scott *vs.* Armstrong; also *2 Bolles, Modern Law of Banking (1907) p. 742*, quoting the same passage.

In *Rolling Mill Company* vs. *Ore and Steel Company, 152 U. S., 596, 615*, it is said:

> "Cross-demands and counterclaims, "whether arising out of the same or wholly "disconnected transactions, and whether "liquidated or unliquidated, may be enforced "by way of set-off whenever the circum-"stances are such as to warrant the inter-

> "ference of equity to prevent wrong and "injustice. Again, it is well established "that equity will entertain jurisdiction and "afford relief against the collection of a "judgment where in justice and good con- "science it ought not to be enforced, as where "there is a meritorious, equitable defense "thereto which could not have been set up "at law, or which the party was, without "fault or negligence, prevented from inter- "posing (citing cases). The adjustment of "demands by counterclaim or set-off, rather "than by independent suit, is favored and "encouraged by the law, to avoid circuity of "action and injustice (citing cases). By the "decided weight of authority it is settled "that the insolvency of the party against "whom the set-off is claimed, is a sufficient "ground for equitable interference"

(citing many cases and then quoting *Schuler* vs. *Israel, 120 U. S., 506*).

In *Armstrong* vs. *Chemical National Bank, 41 Fed. Rep. 234*, the Fidelity National Bank of Cincinnati, which was largely indebted to the Chemical Bank, negotiated for a further loan on specific securities. The Chemical Bank advanced some money after receiving the securities, but asked that the equity be pledged to cover all indebtedness. Before a definite agreement was reached, an attachment was served and the Fidelity Bank failed. Judge Wallace said:

> "Under the circumstances, any overdraft "made after the securities were sent to the "defendant and after it had advanced the "$200,000, should be regarded as one allowed "on the faith of the securities, in the absence "of distinct evidence to the contrary"

(p. 238); and he allowed a set-off to that extent.

The same liberal rule is recognized in *N. Y. Co. Bank* vs. *Massey, 192 U. S. 138*.

Even under the strict rules prevailing in the State courts of New York, the set-off claimed here

would have been allowable in an action at law, and the contract indebtedness on the overdraft could have been counterclaimed under the Code against the claim in tort for the retention of the notes (*Fera* vs. *Wickham*, *135 N. Y., 223*; *DeCamp* vs. *Thompson*, *159 N. Y., 444*; *Empire Feed Company* vs. *Chatham National Bank*, *30 App. Div., 476*, and cases cited; *Thompson* vs. *Kessel*, *30 N. Y., 383*; *G. & H. Mfg. Co.* vs. *Hall*, *61 N. Y., 226, 236*; *Brown* vs. *Buckingham*, *21 How. Pr., 190*).

The case is one, which, it would seem, should peculiarly appeal to a court of equity. The action of the Hanover Bank in allowing the overdraft was not for its own benefit or advantage, but in the obvious interest of the Abilene Bank. Their relation as correspondents, the inability to communicate directly, owing to the distance, and the unusual circumstances, combined, fully justified, if they did not require, the action taken. It is a frequent occurrence for the accounts of out-of-town banks to be overdrawn, owing to the failure or delay of expected remittances, and some indulgence in this respect is usual and proper and should be encouraged. Otherwise a New York bank, acting on the strict letter of the law contended for by the appellee, would be forced to refuse checks beyond the amount on deposit and perhaps irretrievably ruin the credit of a correspondent bank, no matter what might be the cause, or however reasonable the explanation.

The appellant respectfully submits that the Hanover Bank is equitably entitled to retain the amount advanced by it and that the decree below should be reversed, and the Receiver restrained from prosecuting the action at law to enforce his claim against it for the same amount.

PERCY S. DUDLEY,
Counsel for Appellant.

SUPREME COURT OF THE UNITED STATES;

OCTOBER TERM, 1908.

Office Supreme Court,
FILED
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JAMES H. McKENN

No. 163. 12

THE HANOVER NATIONAL BANK OF THE CITY OF NEW YORK,

Plaintiff in Error,

vs.

WILLIAM F. SUDDATH, as Receiver of the American National Bank of Abilene,

In Error to the Circuit Court of Appeals for the Second Circuit.

No. 164. 13

SAME,

Appellant,

vs.

SAME.

Appeal from the Circuit Court of Appeals for the Second Circuit.

Brief for Defendant in Error and Appellee.

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Supreme Court of the United States.

THE HANOVER NATIONAL BANK OF THE CITY OF NEW YORK, Plaintiff in Error, *vs.* WILLIAM F. SUDDATH as Receiver of the American National Bank of Abilene.	No. 163.

IN ERROR TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

SAME, Appellant, *vs.* SAME.	No. 164.

APPEAL FROM THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Brief for Defendant in Error and Appellee.

No. 163 was originally an action of replevin under the New York practice (p. 7), brought by Rich-

ard L. Van Zandt, predecessor of defendant in error, as Receiver of the American National Bank of Abilene, Texas, against this plaintiff in error The Hanover National Bank. It was brought to recover the possession of four promissory notes. Three of the notes were collected by defendant *pendente lite* and part of the proceeds thereof remitted to plaintiff; and defendant then delivered the fourth note to plaintiff. The amount reserved by defendant in making the payment aforesaid was $3,725.86, being an amount owed to it by the bank of which plaintiff is receiver. The answer was amended at the trial by setting up these facts (pp. 16-17). The case was tried before Judge Hough and a jury on November 20, 1906. A verdict was directed for the plaintiff for $3,725.86, and defendant excepted.

Statement of Facts.

No. 163.

Defendant (this plaintiff in error), the Hanover National Bank, was the New York correspondent of the American National Bank of Abilene, Texas. The latter bank, besides making deposits and withdrawing them by checks or bills of exchange, from time to time sent commercial paper, offering it to defendant for sale. If the Hanover bank purchased, the proceeds were deposited by it to the credit of its correspondent (Answer, Par. V., p. 10, admitted p. 16).

On November 27, 1903, the Abilene bank signed one of the familiar so-called cutthroat agreements.

It is annexed to the answer (p. 14), and the important portion is set forth at the commencement of our Point II, *infra*.

On January 18, 1905, the Abilene bank closed its doors (p. 19) and its receiver was appointed (Complaint, Par. III, p. 5, not controverted). The four notes which its receiver sought in this action to replevy are claimed by plaintiff in error, both under a general banker's lien and under the agreement above quoted.

Two of these notes had been mailed to the Hanover bank by the Abilene bank's President on January 9 and 10, 1905, respectively, with letters saying "We hand you" the notes "for discount and credit." The letters had been received January 14 with the notes enclosed, and the Hanover bank upon their receipt had sent two telegrams concerning them. The first of these telegrams read "Referring letters ninth and tenth not agreeable." The second read "Referring previous despatch transfer or ship currency" (p. 17).

The other two notes had been mailed on January 12, also in a letter saying "We hand you" the notes "for discount and credit." This letter had been received January 16 with the notes enclosed, and the Hanover bank had telegraphed back "Not satisfactory" (p. 17).

On January 17, having received no answer to any of these telegrams, the Hanover bank had wired for an answer to those of the 14th (p. 18).

The above statement includes all correspondence prior to the failure, which was received by the party addressed; and there were no oral transactions.

Certain other letters, mailed before or about the time of the failure, were not received by the addressees until thereafter, owing to the fact that the mail between Abilene and New York requires approximately four days (p. 16). These letters were put in evidence by plaintiff in error, and are as follows:

A letter of January 16 from the Hanover bank, referring to the two notes mailed from Abilene on the 12th. This letter said (p. 18):

> "We are not discounting the enclosures for you but hold same as collateral to your indebtedness to us, and remain."

Another letter of January 16 from the Abilene bank, referring to the telegram refusing to discount these two notes, urging their discount, and offering as an alternative to send bills payable with collaterals attached (p. 18).

A letter of January 17 from the Hanover bank, saying (p. 18):

> "As your account showed overdrawn today over $3000, we have made you a temporary loan of $3500 against collateral in our hands."

On the morning of that date, January 17, there stood on the Hanover bank's books to the credit of the Abilene bank the sum of $616.15. There would have been a sum to its credit at the time of its failure, notwithstanding the refusal to discount these four notes, if it had not been for an item of $3825.45 which came in on that day. This was the Abilene bank's check upon the Hanover bank, dated January 11, to the order of the New York Life Insurance Company, collected on January

17 through the clearing house. The Hanover bank entered on its books a loan of $3,500 to the Abilene bank, which resulted in a debit balance on the morning of the 18th of $63.86 (p. 18).

It is not shown that there was any authority for this $3500 entry, or that the Abilene bank was informed of it, although the amount is precisely that of one of the four notes in suit (p. 17). On the other hand, the explanation given by defendant's vice-president is, that upon the overdraft of January 17, 1905, being called to his attention "he got out the agreement, a copy whereof is annexed to the answer, looked at it, and believed that he had a right to hold these four notes as collateral; that he relied upon the four notes and whatever rights he would have in regard to them by collateral agreement or otherwise, when allowing the overdraft" (pp. 18-19).

No. 164.

The facts are substantially the same, but stated in the form of a bill in equity to establish an equitable set off and enjoin the prosecution of the receiver's action No. 163.

The Opinions Below.

The case was originally tried before Lacombe, J., who directed a verdict for defendant. The judgment was reversed, Wallace, J. (Townsend and Coxe, JJ., concurring), saying (Van Zandt *v.* Hanover Bank, 149 Fed. Rep., 127):

> "The Abilene bank had not asked for a temporary loan, and was entitled to have its

notes used as it had directed, so as to realize their full proceeds; and if not so used, it was entitled to make such disposition of the notes as it saw fit. As the notes had been sent to the defendant for a specific use, they did not become subject to a general banker's lien. Such a lien does not attach upon securities which are deposited with the banker for a special purpose.

* * * * * * * *

"The language of the agreement of November 27th is susceptible of different interpretations. It may be read as follows:

"'That all * * * notes * * * owned by the undersigned * * * deposited with said bank * * * or which may be in any wise in said bank or under its control, as collateral security * * * or otherwise, * * * may be held, collected and retained by said bank.'

"Read in this way, it is capable of being construed as a pledge of all notes belonging to the Abilene bank that may in any way come into the hands of the defendant, even though they come accidently or against the will of the Abilene bank. But such a reading omits a material part of the instrument [&c. p. 15, *infra*].

* * * * * * * *

"If the agreement had been intended to pledge all securities belonging to the Abilene bank that might come in any manner to the hands of the defendant, or even of all that might rightfully come to its hands, that intention could have been manifested unmistakably, and in very simple terms, by omitting the words 'deposited' and 'as collateral security,' etc. The latter are descriptive words which identify the securities which the defendant may hold and collect by reference to the purposes for which they come into his hands. If the contention for the defendant

in error is correct, these words were used unnecessarily.

"The language of a contract is always presumed to be used with reference to the matter in the minds of the parties when they contract. Therefore words of broad signification will be interpreted with reference to the subject matter of the contract, unless the intention is clear that they should be taken in the broad meaning. Jones, Construction of Contracts, § 220. The parties here were contracting with reference to notes, property, etc., which should be deposited by the Abilene bank with the defendant, or should come under its control as collateral security for certain obligations and liabilities, and the general words 'or otherwise' should be held to relate to notes and property which should come to the hands of the defendant by way of deposit or collateral security, or some other kind of bailment.

"It is apparent, from the fact that the Abilene bank is not named in the instrument, otherwise than as 'the undersigned,' that it was one for general use prepared by the defendant. Such instruments are always to be construed most strictly against the party by whom they have been prepared. This rule was applied to an instrument like the present one in Gillet *v.* Bank of America, 160 N. Y., 549, 55 N. E. 292. It is not to be inferred, in the absence of clear terms, that the Abilene bank intended to authorize the defendant to keep and collect such of its notes or property as it did not intend to part with, or such as might be obtained by the defendant without its consent.

"The notes in controversy were never deposited by the Abilene bank with defendant, nor did they come into its hands as collateral security within the commonly accepted mean-

ing of these terms. They were temporarily in the hands of the defendant under an option to purchase them. We conclude that they did not come within the terms of the pledge, and that the defendant did not obtain a lien upon them.

"If the check drawn by the Abilene bank upon the defendant, which caused the overdraft of its account, had been drawn with knowledge of the defendant's refusal to discount the notes, a different question would be presented; but it is fair to assume that this check was drawn in the expectation that before its presentation the notes would have been discounted and the proceeds credited to the Abilene bank."

In their opinion upon the present appeal the same judges say (Hanover Bank *v.* Suddath, 153 Fed. Rep. 1022, Record No. 164, p. 15):

"It is manifest that if the Hanover Bank was unauthorized to use the notes sent to it by the Abilene bank, except for the specific purpose mentioned in the letter of instructions transmitting them, this action cannot succeed. The mere fact that property of the Abilene Bank was temporarily in the hands of the Hanover Bank did not give the latter a right to apply that property in payment of the former's overdraft. The Hanover Bank was under no legal obligation to pay the checks of the Abilene Bank, when that bank had no balance on deposit with which to meet the checks. The Hanover Bank, in paying these checks and thus creating an overdraft, undoubtedly acted from the most praiseworthy motives; but the failure of the Abilene Bank on the succeeding day subjected its property, wherever situated, to the payment of the claims of its creditors, &c."

Argument.

I.

The Hanover Bank had no general banker's lien on the four notes.

The general banker's lien arises from a usage which has been judicially noticed by the courts as part of the law merchant (Brandao *v.* Barnett, 12 Cl. & Fin. 787). The usage is "controlled by any special agreement which shows that it was not intended by the parties; as it may also be repelled by circumstances showing that the securities did not come into the hands of the banker, or were not held by him in the ordinary course of business" (Story on Agency, § 381). The more familiar exceptions are when the securities upon which the lien is claimed are "accidentally in its possession, or not in its possession in the course of business as a bank" or when they are deposited for a special purpose (1 Morse on Banks and Banking, 4th Ed. pp. 597-9). The banker's lien is not applicable as a general rule when the "securities were delivered to him under a particular agreement" (Bank of Metropolis *v.* New England Bank, 1 How., 234-239), or in any way indicating no intent to subject to a lien (Leese *v.* Martin, L. R., 17 Eq., 224, 235).

The general subject was under thorough investigation by this court in Reynes *v.* Dumont, 130 U. S. 354, a case argued by leading counsel. The Chief Justice said (pp. 390-4), that while the general lien (quoting from Kent) "is founded on custom and is not favored" and is "looked at with

jealousy'' yet that it ''does arise in favor of a bank or banker out of contract expressed, or implied from the usage of the business, in the absence of anything to show a contrary intention. It does not arise upon securities accidentally in the possession of the bank, or not in its possession in the course of its business as such, nor where the securities are in its hands under circumstances, or where there is a particular mode of dealing inconsistent with such general lien'' (Citing Brandao *v.* Barnett). He quotes from National Bank *v.* Insurance Company, 104 U. S. 54, 71, that the lien ordinarily ''attaches in favor of the bank upon securities and moneys of the customer deposited in the usual course of business,'' etc., and adds that ''if, as argued by counsel, there is a presumption, as between customer and banker, that the securities or property of the customer, found in the possession of the banker, have been left with him to secure him generally against loss, this is not an irrebuttable presumption, and each case stands upon its own circumstances.''

The most familiar exception to the general banker's lien is the case of a deposit of money or security to secure against some particular liability. This is an exception because it appears that the parties had a special agreement about the matter, and therefore there is no ground for implying any other agreement from general usage. It is mainly this exception which the banks seek to meet by such ''cutthroat agreements'' as the one shown in the present case, and which will be discussed under the next point of our argument.

In addition to this more common exception to the general rule, there are other exceptions based

upon similar reasoning; namely, in the words which I have quoted from this Court, where the founds or securities in question were not in the bank's possession "in the course of its business as such" or where they are in its hands under circumstances inconsistent with such a general lien.

Reynes *v.* Dumont was itself such a case. The securities in question had been sent to the bankers for a specific purpose. That purpose had been accomplished, but they had been permitted to remain in the banker's hands as depositaries because they were in a good market and a place convenient for procuring loans, and because the expressage upon their return would have been very heavy. The decision (negativing the lien) was partly based upon that in Biebinger *v.* Continental Bank, 99 U. S. 143, where a deed had been on deposit with the bank as collateral security for the customer's current indebtedness and discounts. After payment of this indebtedness and a temporary suspension of dealings he incurred new indebtedness to the bank, but as it did not appear that the money was loaned or debt created on the faith of the deed, the bank's claim of a lien thereon was denied (130 U. S. at pp. 392-3).

The reasoning of all these authorities leads to the conclusion that a general lien cannot attach to securities which are handed to a banker in order that he may do a particular thing with them, when he refuses to do that thing. After such refusal they are no longer in his hands at all except physically, and it is his duty to hand them back again.

While this precise state of facts seems not to have arisen in the Federal courts before this case, there is ample authority upon it elsewhere. Thus

Mr. Justice Story enumerates among the cases where the general lien does not attach because the property is not held in the ordinary course of business the case of instruments "casually left at the banking house after he has refused to advance money on them as a security" (Story on Agency § 381). Mr. Morse also instances as an example of this exception to the rule the case of "securities left with the bank after its refusal to discount them or loan money on them" (Morse, *ubi sup.*). Mr. Jones lays down the same rule (1 Jones on Liens, 2nd Ed., § 244).

The leading case everywhere cited is Lucas *v.* Dorrien, 7 Taunt., 278, decided in 1817. The defendants were bankers. A customer brought a lease to the bank asking for an advance upon it. The bank refused, and he left the lease lying there without saying why. The Court held that the bank had no lien upon the lease. The point, although it had been properly reserved, seems to have been conceded upon the argument, the only reference to it in the opinions being by Burrough, J., who said, "There is not a question as to the lease."

This case was followed in Petrie *v.* Myers, 54 How. Pr. (N. Y.), 513, where a note had been offered to the bank for discount, which was refused, but the bank claimed to hold it for the general balance of account.

In Brandao *v.* Barnett, a customer had left with his bank some exchequer bills to be exchanged for new bills. Before the exchange was made he was taken ill, and they were left for a long time. The Exchequer Chamber held that the bills were subject to the general banker's lien, distinguishing

the Lucas case on the ground that in that case the banker was not in possession "in the way of his business" (6 Man. & G., 630, 666). The House of Lords reversed the decision and held that there was no lien (12 Cl. & Fin., 787).

In Bank of Montreal *v.* White, 154 U. S., 660, the question arose between the bank and the maker of the note which it claimed as collateral security. The transaction was quite similar to that in the present case. As apears by the record, a customer wrote the bank enclosing the paper and saying, "Please discount and place to my credit, and charge me with the overdraft you kindly allowed on Friday." The bank advanced moneys, but afterwards asked its customer to get the notes discounted elsewhere. This the customer was unable to do, and finally the bank consented to make the discount. The notes were subject to an equitable defense as between the original parties. Plaintiff (the bank) requested a charge that if it had paid out any money on the strength of the paper offered as collateral it was entitled to the extent of such payment to protection as a *bona fide* holder for value, although it "did not in fact enter said notes to the credit of said company as a discount until after such advances were made." The Court refused to charge this, and charged instead that the case turned on the question whether the bank had notice of the advance before it actually entered the discount. The bank coming up on a writ of error, Chief Justice Waite said that "It is nowhere even in the remotest degree intimated that if the discount was declined the note might be kept as collateral. The charge asked and refused was therefore wholly immaterial and the

judgment cannot be reversed because it was not given."

Such a transaction makes the bank a trustee of the paper, to apply it as directed by the sender (see Libby *v.* Hopkins, 104 U. S., at page 309).

The passage relied upon from Continental Bank *v.* Weems, 69 Texas, 489, was *obiter,* so far as the appellate court is concerned, for the receiver did not appeal.

II.

The Hanover Bank had no lien upon the four notes by the agreement of November 27, 1903.

That agreement, which is signed "The American Nat'l. Bank, by J. G. Lowdon, Pt.," is as follows:

> "For and in consideration of one dollar [&c.], the undersigned agree with said Bank that all Bills of Exchange [&c.] owned by the undersigned, or either or any of them, or in which they, or any or either of them have any interest deposited with said Bank, or which may hereafter be deposited with said Bank, or which may be in anywise in said Bank, or under its control, as collateral security *for loans or advances already made or hereafter to be made to or for account of the undersigned, by said Bank,* or otherwise, may be held, collected and retained by said Bank, until all liabilities present or future of the undersigned, or any or either of them, due or not due of every kind to said Bank, now or

> hereafter contracted, shall be paid and fully satisfied" [&c.];

with right to sell on one day's notice at public or private sale, &c.

The Circuit Court of Appeals point out (p. 6, *supra*) that the instrument is ambiguous, and that by disregarding the passage above italicized it could be construed so as to impound all paper physically in the bank's possession, however it got there. But the court proceeds to say:

> "With these [italicized] words supplied, the words 'or otherwise' may be read as referring to the nature of the liability for which the collateral is security, and as meaning to pledge the collateral, not only for loans and advances, but for any liability otherwise arising, such, for instance, as that of an indorser or surety upon the commercial paper of third persons."

The instrument thus construed extends the general banker's lien so as to take in two classes of securities: first, those pledged by the signer for a specific loan or advance to itself; and second, (by operation of the words "or otherwise") those pledged by the signer for a specific loan or advance to some other person, for whom the signer is surety. The words "or otherwise" also bring within the instrument collateral deposited by the signer with some other bank or third party upon discount by the latter of paper subsequently rediscounted upon the same security by the Hanover bank.

The Circuit Court of Appeals has pointed out that the language of the instrument shows it to be on a form prepared by the Hanover bank. This appears not only from the word "under-

signed", but also from the words "or either or any of them"; and is indeed conceded (Brief for Plaintiff in Error, p. 6). Hence the instrument is to be construed strictly against the bank (p. 7, *supra*). The "undersigned" can not be presumed to have intended that it would apply to paper non-contractually obtained by the bank, although for the moment geographically "in" its premises, and physically "under its control." Even if such an agreement might attach in a case like Brandao *v.* Barnett, it could not without violating all principles of good faith be applied to a case like Petrie *v.* Myers.

To illustrate, let us suppose that the Abilene bank had sent the notes by a special messenger; that he had come into defendant's office and asked that they be discounted; that defendant's clerk had asked, as would be natural, for a look at the notes; that they had been handed to him, and that on examination he had concluded to reject them. The notes would then indeed be geographically "in said bank." They would be in the grip of an agent of the bank, behind a metal screen, and physically out of the power of the Abilene messenger to reclaim. Were they in the bank or under its control within any admissible construction of this agreement, so that the messenger would not have the right to demand them back again and take them to some other correspondent for discount? Like a diner handling the knives and forks of a hotel, has not the bank a mere custody as distinguished from the possession of the notes? And is not the case precisely the same here, where the letters are entrusted to the mail instead of to a messenger?

To illustrate again, let us suppose that the notes had been stolen, or diverted by a forged indorsement, or had blown in through the window, and had thus come into the defendant's physical possession, but with notice of the Abilene rights. Does any admissible construction of the agreement permit the defendant to say "We are indeed not *bona fide* holders and cannot claim to *own* the notes, but we shall *hold* them as pledgees under your agreement because they have got into our control?"

In short, does the agreement mean "We are to have a lien upon any paper we can lay our hands on, whether we obtain it by fair means or foul"?

Assuming that the words "or otherwise" are broad enough to cover securities that are in the bank neither by way of deposit nor by way of collateral, still the words are to be construed in the light of the rule *nosc itur a sociis*. They cannot reasonably be construed to add to the cases of deposit and collateral security any case that is not contractual in its nature—that does not involve a contract upon which the minds of both parties to the agreement, or of others with whom they are in privity, have met.

III.

There was no other agreement under which the Hanover Bank had the right to retain the notes.

It did not claim even on the second trial to have relied on any describable agreement or promise,

tacit or express, except the paper of November 27, 1903 (Record, No. 163, pp. 18-19). Evidently that paper was its sole reliance. Had this not been so, it would doubtless have wired, instead of mailing, the notice that it claimed to hold the notes as general collateral.

Nor is it able now to spell out any agreement upon which it would have had a right to rely.

To constitute an agreement there must be a proposal and acceptance.

The first proposal was that the notes be re-discounted. This was rejected.

The subsequent proposal was in transit at the time of the failure, and was therefore never accepted. When the Abilene bank failed, its property rights passed by operation of law to the present plaintiff as its receiver. Among the circumstances which revoke an offer before acceptance is "bankruptcy of one of the parties, which transfers all his property to trustees" (John D. Lawson, in 9 Cyc., 293, citing Meynell *v.* Surtees, 25 L. J. Ch., 257, 262). In the case cited an offer of a "way-leave" was made to a railroad company, but before the offer was accepted the offerer became a bankrupt. Lord Cranworth said, "I am perfectly satisfied in point of law and have no hesitation in saying that if Mr. Ord had been the owner * * * that paper falls to the ground entirely by his bankruptcy; because all his interest was transferred to somebody else", etc. Putting it another way, a contract is not made until the proposal is accepted, and a proposal to subject property to a lien cannot result in anything effectual when the property has passed to a third party before the proposal has reached the person to whom it is made. The rights of the general creditors

had then attached (see Scott *v.* Armstrong, 146 U. S., at p. 511).

Nor did this unaccepted proposal include the pledging of these four notes as general collateral. It was that the Hanover bank reconsider and allow the discount, or "we *will send* our B/P with collaterals *attached.*" The alternative offer must relate to some papers then in Texas, not New York. This our learned adversary overlooks.

The Hanover bank made no counter-proposal, but simply wrote its correspondent, first, that it was impounding the four notes under a claim of general lien, and second, that it was making a temporary loan of $3,500. The first it had no right to do. The second was merely a method of entering part of an overdraft which it chose to pay. Neither notice reached Abilene before the rights of the general creditors had attached.

Its main reliance now seems to be on the theory that the New York Life Insurance Company check of $3,825.45, which was issued on January 11 and caused the overdraft, was issued in expectation of meeting it with the two notes sent January 9 and 10. Assume this to be true. But the expectation was that these notes would be discounted. No doubt as to this was ascertained. They were sent for no other purpose. Hence the Hanover bank could not connect the transactions together except by accepting the proposition to discount these two notes, and paying the check out of the proceeds; or if it preferred to do so, it could have discounted the two later notes instead.

It could not pay the check and hold any of the notes, except by discounting them. In other words,

it could not pay the check and thus immediately create a *secured* liability, payable *on demand*. It could throw out the check, or else pay it and accept security payable later in the year. The latter course would have been accommodating, and it would have been safe as things turned out.

Its position as a reserve bank gave it no privilege to tamper with its correspondent's rights. If its correspondent was solvent, even an unsecured overdraft would have been harmless. If its correspondent was insolvent, then the creditors were the real parties in interest, and its duty was to preserve their equality as far as possible, and not prefer the New York Life Insurance Company.

Had the notes been discounted, the Abilene bank would have obtained thereby nearly $10,000 cash with which it would have been at once credited. Over $6,000 it could have forthwith used for any of its purposes, having with the balance provided for the New York Life Insurance Company draft. *Non constat* that it would not have been able thus to avert insolvency. It would indeed have remained contingently liable as indorser; but this liability, as the event has showed, would have amounted to nothing in the case of three at least of the four notes.

What the Hanover bank now asks is in effect to be put where it would have been if it had accepted the request to discount instead of rejecting it—to imply an agreement contrary to the fact—an agreement which was proposed, but which its own mistake of law and error of judg-

ment and desire to gain a greater advantage prevented. This the court cannot do—and especially after a failure that may have been caused by the course which complainant elected to take.

The fact that the Hanover Bank saw fit to enter a loan of $3,500 on its books does not alter the legal significance of the transaction. The transaction was not a loan, but something quite different—the payment of a draft by the drawee, although the draft was unaccepted and no funds had been provided by the drawer with which to meet it, or collateral with which to secure the payment. Such a payment is a not unusual courtesy, and it raises a liability by the drawer to the drawee, but creates no lien.

Having no funds and no collateral, complainant's proper course was to refuse payment of the New York Life Insurance Company draft, and telegraph its correspondent to that effect. This might have elicited some agreement that would have enabled the draft to be taken up. If not, then the result would have been to make the insurance company an unsecured creditor, and leave it to prorate with the Abilene bank's other unsecured creditors.

By taking up the draft, complainant merely stepped into the shoes of the insurance company, and became an unsecured creditor itself.

IV.

There is no question of set-off, legal or equitable, properly in the case.

Set-off is a doctrine which applies as between two claims each for a sum of money. The receiver's demand for relief shows his action to have been one of replevin (Record No. 163, pp. 7-8; No. 164, p. 5; N. Y. Code Civ. Pro., §§ 1718, 1726, 1730; 2 Abbott's Forms of Pleading, p. 869); and hence it is obviously not subject even to a statutory counterclaim, for a sum of money can not be deducted from the possession of four notes (Moffat *v.* Van Doren, 4 Bosw., 609; N. Y. Code Civ. Pro., § 501; 1 Nichols' N. Y. Practice, 972, and cases cited; Dinan *v.* Coneys, 143 N. Y., 544). The judgment reversed was for a sum of money, because the notes had been parted with or returned to the receiver, *pendente lite.*

Equitable as well as legal set-off is a doctrine applicable only to pecuniary cross-demands. Of that nature was Scott *v.* Armstrong, 146 U. S., 499.

The bill in No. 164 is not properly a bill for an equitable set-off, but a bill to declare certain notes to have been subject to a quasi-contractual lien that would have been enforceable in equity but not at law.

V.

There is no equity in the bill in No. 164.

If the Hanover Bank had any remedy it had an adequate remedy by defending the receiver's action at law, in which respect the case differs from Scott *v.* Armstrong, *supra*. Its learned counsel fully protected its interests, and this bill which he subsequently filed *ex majori cautela*, though prudent, was unnecessary, and properly dismissed as devoid of equity (pp. 8-9). If there was any agreement, express or implied, giving the bank the right to claim a lien on these four notes, it was a right not depending upon any distinctively equitable theory, in the jurisdictional sense of that term. Hence the merits of the controversy are to be decided upon the record in No. 163, which we have already fully discussed.

For the foregoing reasons it is respectfully submitted that the judgment and decree should be affirmed.

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